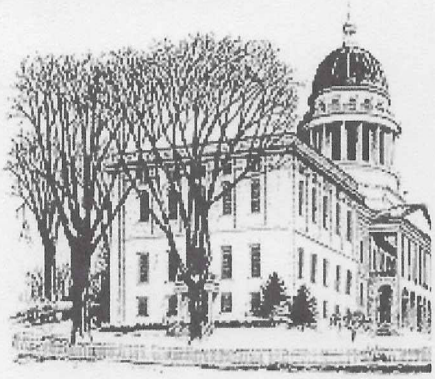

STATE OF MAINE
REVENUE FORECASTING COMMITTEE

Members:

Michael Allen, Chair, Associate Commissioner of Tax Policy
Beth Ashcroft, State Budget Officer
James Breece, University of Maine System
Marc Cyr, Principal Analyst, Office of Fiscal and Program Review
Christopher Nolan, Director, Office of Fiscal and Program Review
Amanda Rector, State Economist

August 1, 2020

TO: Governor Janet T. Mills
Members, 129th Legislature

FROM: Michael Allen, Chair
Revenue Forecasting Committee

RE: Revenue Forecast Committee's August 1, 2020 Report

The Revenue Forecasting Committee (RFC) has concluded a rare "off-cycle" update of its most recent revenue forecast (March 1, 2020) in order to incorporate the new economic forecast released by the Consensus Economic Forecasting Commission (CEFC) on July 1, 2020 and to provide the Governor and Legislature with a revenue forecast that reflects the impact of the COVID-19 pandemic. Tables showing the changes made to all the funds forecasted by the committee and a detailed presentation that includes the key assumptions made in developing the forecast have been posted to the RFC's web page and are available here. A more complete report will be added to the web page later next week.

In its August 2020 update, the RFC has revised General Fund (GF) revenue estimates downward by $527.8 million for FY21 and by $883.2 million for the FY22/23 biennium. The forecasted rate of year-over-year growth for General Fund revenue in FY21 is now -10.8%, followed by growth of 5.6% in FY22 and 3.4% for FY23. In addition, Highway Fund revenues are being reduced by $30.8 million in FY21 and $30.5 million in the FY22/23 biennium.

The CEFC forecast is always a key input for the RFC and that is certainly the case in the August revenue forecast. The CEFC convened on June 25, 2020 to review and revise its February 1, 2020 forecast. Maine saw strong employment numbers in the first three months of CY20 before seeing record-setting job loss beginning in April. The CEFC now projects that total nonfarm employment will decrease by 8.0% in CY20, with growth of 4.0% and 2.0% in CY21 and CY22, before leveling to 0.0% in CY23-25. The forecast anticipates employment will decline from around 636,000 in CY19 to a trough of around 585,000 in CY20, recovering to around 621,000 in CY22 before leveling off. This compares to a peak of 639,400 in the previous forecast.

Total personal income was revised down to an annual growth rate of 3.9% in CY20, 0.2 percentage points lower than the February 2020 forecast. The forecast for CY21 was revised down by 5.2 percentage points for an annual decline of -1.2%. The forecast is largely driven by a substantial increase in personal current transfer receipts in CY20 that will have expired by CY21. Changes to minor income lines resulted in upward revisions of 0.1 percentage points in CY24 and CY25.

In their report the CEFC emphasized that current conditions are unprecedented, highly uncertain, and include a large number of unknown variables. The economic forecast update represents the best the Commission could do with the information available at the end of June. Several key assumptions had to be made, encompassing both the public health situation (no subsequent outbreaks of COVID-19 in Maine requiring a lockdown) and economic conditions (further federal stimulus will follow later this year that includes support for state and local governments, the unemployed, and lower-income households), increasing the level of uncertainty associated with the forecast. Unpredictability, while always an element in the forecasting process, is front and center in the CEFC July forecast.

Almost 95% (-$498.3 million) of -$527.8 million reprojection in FY21 by the RFC is from sales and use and individual income taxes, and 100% of the FY22 and FY23 net reductions are attributable to these two revenue lines. In both cases, swift and unprecedented stimulus from the federal government and the Federal Reserve System has helped to moderate the initial impact on State revenues of the historic COVID-19 recession during the final quarter of FY20. While the CEFC assumes that Congress will provide an additional $1 trillion of stimulus during CY20, the temporary nature of that stimulus and a weak recovery for the Maine economy leads to significant ongoing reductions in the State's two largest sources of GF revenue.

In the case of the sales and use tax line approximately 60% of the $238 million reduction in FY21 is attributable to taxable prepared foods and lodging. Lodging sales are assumed to be down year-over-year by 50% during the third-quarter of CY20, the height of the summer tourism season. Lodging sales are assumed to improve slowly over the remainder of CY20 and are not expected to generate the same level of tax revenue as CY19 until CY22. Prepared food sales, mostly restaurant sales, are projected to perform better than lodging, but are assumed to be down approximately 30% year-over-year during the third-quarter of CY20. Like lodging, prepared food sales are assumed to slowly improve and not get back to the same level of tax revenue as CY19 until CY22. These key assumptions by the RFC about lodging and prepared food sales are consistent with the CEFC's employment forecast for the leisure and hospitality industry. The gradual improvement in both sales categories, representing 25% of total sales tax revenue in a typical year, is the primary reason for the lower decrease in sales tax revenue of $152 million in FY22 and $131.3 million in FY23. One bright note on sales tax is the additional tax revenue the State is collecting because of several recent law changes that require remote sellers to collect and remit sales tax on sales delivered into Maine.

75% of the adjustments to individual income tax revenue is primarily the result of the CEFC's assumption of combined wage and salary and unemployment insurance (UI) benefits growth over the forecast period. The CEFC forecast assumes that the initial enhanced UI benefits that were part of the CARES Act, and a continuation of those benefits at some reduced level in the next federal stimulus package will almost offset the reduction in wages and salaries during CY20. After CY20 the CEFC assumes that UI benefits will fall back to normal levels and growth as unemployment declines, but wage and salary growth will be weaker than their previous forecast. These assumptions result in a growing gap between the February and July CEFC forecast for the combined level of wage and salary and UI benefits, which has a significant impact on individual income tax liability. Other key factors impacting the individual income tax forecast are; (1) the reversal of the FY20 accruals for final and estimated payments in FY21, (2) a larger decrease in capital gains realizations than the March forecast, and (3) a reduction in IRA income in tax year 2020 due to federal tax law changes.

The COVID-19 pandemic has had an impact on our society not seen for 100 years, and an unprecedented impact on the global, U.S., and Maine economies. Public health officials are grappling with spread of the virus and are gaining an understanding of this deadly disease daily. Simultaneously, economists are trying to understand the ramifications of an almost complete shutdown of the world economy and a subsequent phased re-opening. Simply, there's no playbook for forecasting a modern economy during a worldwide

pandemic. The recent economic forecast and this revenue forecast represent the two-forecasting committee's best attempts at forecasting Maine's economy and State revenues over the current and next three calendar years. Both committees will meet jointly for our annual retreat in mid to late September to review both forecasts, discuss incoming economic and revenue data, and will no doubt share ideas on how the next forecasting exercise can be improved. On the heels of the retreat will be the November 1st report of the CEFC and the December 1st report of the RFC. Given the numerous uncertainties expressed by both committees, there's a high probability that significant changes, positive or negative, may be take place in the next forecasting exercise.

cc: Members, Revenue Forecasting Committee
Members, Consensus Economic Forecasting Commission
Jeremy Kennedy, Chief of Staff, Governor's Office
Kirsten Figueroa, Commissioner, DAFS
Clerk of the House
Secretary of the Senate
Grant T. Pennoyer, Executive Director, Legislative Council
Legislative Staff Office Directors